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# IS YOUR MONEY SAFE?

## HOW TO PROTECT YOUR SAVINGS IN THE CURRENT BANKING CRISIS

WARREN G. HELLER

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- How your bank may really be an S&L in disguise
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# ABOUT THE AUTHOR...

DR. WARREN G. HELLER is the research director of VERIBANC, Inc., The Bank Rating Service,™ where he pioneered their unique color-coded and star rating systems for federally insured financial institutions. In addition to his responsibilities at VERIBANC, Dr. Heller consults professionally in the areas of systems analysis, information science, real estate management and financial guidance.

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# DEPOSIT INSURANCE

## *Basic Concepts*

Any person with deposit accounts in a federally insured financial institution has amounts up to $100,000 "covered" by a U. S. government agency. For banks, the deposit insurance is through the Bank Insurance Fund (BIF) of the Federal Deposit Insurance Corporation (FDIC). For S&Ls, the FDIC-administered Savings Association Insurance Fund (SAIF) provides the coverage. The funds for the insurance coverage come from annual premiums paid by each institution. The premiums run in the vicinity of fifteen to twenty cents per hundred dollars of deposits. Credit union insurance, extended by the National Credit Union Share Insurance Fund (NCUSIF), is paid by special assessment on each institution. However, in recent years, the premiums have been waived because NCUSIF has been deemed by the National Credit Union Administration to possess sufficient funds.

Government officials, including presidents, congressional leaders and banking regulators, have frequently assured the public that the full faith and credit of the U.S. government back these insurance funds. Most experts interpret these assurances to mean that, regardless of the solvency of the insurance funds, somehow, some way, the government will do whatever is necessary to return depositors' money to them.

However, there are situations in which the government's ability to repay depositors could clearly be limited. Some of these situations are discussed later in this chapter.

## *Additional Coverage*

The deposit insurance coverage is $100,000 *per person, per bank*. Certain exceptions, such as use of a joint account plus individual accounts, can extend the coverage to $300,000 per couple. By use of trusts and other special devices, coverage can be extended further to $500,000, but the "fine print" provisions of the deposit insurance policy are especially tricky for these higher coverages.

One example of such tricky fine print is a rule that the FDIC uses to assess whether joint accounts are really joint. In the course of a bank liquidation, when the FDIC prepares to pay off insured depositors, its examination of account paperwork may determine that there is a "dominant" owner of each joint account. If there appears to be an uneven split in ownership, the account will be apportioned between the primary and secondary owner in accordance with the degree of control suggested by the bank's records. The $100,000 limit is then applied. In one case, because a wife had overlooked signing a joint account's signature card, the FDIC imputed ownership of the entire account to her husband. The rationale was that the wife possessed no withdrawal privileges.

In summary, the simplest way to remember the main features of federal deposit insurance is the "rule of ones"—one bank, one person, one hundred thousand dollars.



## *Common Misconceptions*

As stated above, federal deposit insurance is per account owner, not per account. Ordinarily, spreading one's money over several accounts at the same bank provides no additional protection, despite what has been printed in several major news magazines and at least one national daily newspaper. Deposits placed in different branches of the same bank are also combined when the regulators make insurance payout determinations. Use of a different name or a middle initial, or even a separate social security number, does not help either. If the bank fails and is liquidated by the regulators, the deposit insurance payout is decided on the simple basis of "who actually owns the money." All of the accounts owned by one person are added up and paid. If that amount exceeds $100,000, only $100,000 is paid.

Another common misconception is that any financial instrument received in return for money brought into a bank is protected. Only deposits are protected. While most banks do not offer uninsured accounts, enough cases have occurred to warrant caution. Examples are provided in Chapter 4. If you are unsure as to whether or not your account is protected, follow up with your state banking agency or consumer protection office. Be wary if words such as "deposit-like," "as good as deposits," "investment in the bank" or "backed fully by the bank" are used.

In many instances, creditors and other people who are owed money by a failed bank are not protected. In the bankruptcy proceedings that follow many closures, the federal regulators' claims for reimbursement for deposit insurance payouts are given preference over the claims of other, unsecured creditors. Thus, there is usually no chance for any recovery by the other creditors.

Some people have the idea that if they owe a bank money, and the bank fails, the amounts they have on deposit will be used to offset the loan. This is true only if the deposits and loans are with the same corporate entity. When regulators tally deposits and offsetting loans for insurance payout considerations, no consideration is given to a depositor's loan position at separately incorporated subsidiaries or affiliated institutions. For example, if you owe $60,000 to a bank's mortgage corporation or its leasing subsidiary, and have $140,000 on deposit at the bank itself, $40,000 of the deposit total is exposed. If the FDIC liquidates a bank and its subsidiaries, the regulators either sell the loans to another institution or pursue collection directly. In either case, if payments are withheld, repossession or prosecution for nonpayment follows.

## *Insurance Coverage vs. Kind of Bank*

Many people become confused when trying to match a kind of bank with the federal agency, if any, that provides deposit insurance. Frequently, one hears questions like, "My bank is a state bank, does that mean it is not federally insured?" *(In fact, it probably is insured by the FDIC.)* The source of the confusion is the bank's name. The name usually reflects the nature of the bank's charter. (The charter is the legal document that permits the bank to conduct certain types of business operations, depending upon what kind of bank it is.) The name usually sheds little or no light on the identity of the deposit insurer.

Confusion can also arise because the principal government agency that regulates a financial institution may be *different from the agency that is responsible for its deposit* insurance. For example, all "national" banks are regulated by the Office of the Comptroller of the Currency, but are insured by the FDIC. Some credit unions are both state regulated and state chartered but are insured by the National Credit Union Administration, a federal agency. The list below identifies the three federal deposit insurance plans and the types of institutions that are insured by each.



| *Federal Agency Responsible for Deposit Insurance* | *Types of Institutions Which May Be Insured By Each Agency* |
|---|---|
| FDIC Bank Insurance Fund (BIF) | National banks, state banks, banks which are Federal Reserve board members, some savings banks, some cooperative banks, some thrift and loan associations |
| FDIC Savings Association Insurance Fund (SAIF) | Savings and loan associations, building and loan associations, federal savings banks, some savings banks, some cooperative banks, some thrift and loan associations |
| National Credit Union Administration Share Insurance Fund (NCUSIF) | Federal credit unions, state credit unions |

## *When a Bank Fails*

The mechanics of bank closures are usually set in motion several weeks before the event actually occurs. The regulatory agency responsible assembles a special team, sets a date (often on a Thursday) and begins preparations, all with the highest level of secrecy. Early in the bank's last week, the closing team travels to the city where the bank is located, often spreading out to many motels to avoid detection. On the evening before, selected news media, known for their ability to be discrete, are contacted and advised of the time and place of the closing.

On the final day, usually at the end of normal business hours, the liquidation team assembles, with U.S. marshals, local police and news media, then quickly enters the bank. The lead liquidator announces that the bank is being closed and that all personnel, from that moment on, are employees of the U.S. government. The announcement often generates shock and disbelief among the bank's employees, who often have little idea that the bank is in trouble, let alone a candidate for closure. (For example, just a few weeks before one of the most well-known closings of the 1980s, an officer of Penn Square Bank—taken over by the regulators on July 1, 1982—invested over one million dollars in the bank's stock.) An emotional scene typically follows, in which stunned and crying people are briefed on their responsibilities as public servants and how they are to help the regulators close the bank. Management officials are usually escorted out of the bank immediately. Automatic teller machines are also quickly deactivated.

## *Recovery of Insured Deposits*

Over the weekend that follows, regulators make arrangements for depositors to receive access to their money, usually by transferring the accounts to another bank or, in some cases, preparing to disburse the accounts directly. Out of state account holders are notified by first class mail. To claim their money when a failed institution is liquidated, depositors must fill out an insurance claim form, have it notarized and submit it to the liquidating regulator. If done by mail, normal recovery of deposit account money most often takes several weeks. When the claim is con-



tested by the regulatory authorities, payment can be considerably delayed, if made at all.

In a case involving the failure, in 1985, of the Golden Pacific Bank, located in New York City's Chinatown, a set of disputed "yellow certificates of deposit" were not repaid to customers until 1989. The repayment followed a lengthy court fight between the FDIC and the account holders. The name "yellow CDs" came from the color of the paper the depositors' receipts were printed on. The FDIC could not find records in the bank for the certificates and, on that basis, refused to honor them.

## *How Longer Recovery Times Can Occur*

Although seldom used, banks, and regulators who take over banks, can invoke their right to require a "minimum notice of withdrawal." This means that thirty days notice of the depositor's intention to take out money has to be given. Under some circumstances, including times of "national emergency," state and federal officials can ration the amounts allowed to be withdrawn. They can also postpone withdrawals. Both of these devices have seldom been used since the Great Depression. One instance of a deposit payout deferral that lasted for almost one week occurred when the Sparta-Sanders State Bank in Sparta, Kentucky, was closed on April 18, 1983. The bank's former management obtained a court injunction to keep the FDIC from liquidating the accounts.

Rationing of withdrawal amounts was imposed for a short time during the 1962 closure of a West Virginia bank. Recent, more widespread cases of rationing applied to curb withdrawal activity when federal deposit insurance was not involved are discussed later in this chapter.

## *Actions by the Regulators to Limit Deposit Insurance Coverage*

Due to the heavy drain on federal deposit insurance funds in recent years, banking regulators have begun to take a stance on payouts that is more usually associated with private insurers. They examine all claims and disqualify those that do not meet every aspect of the deposit insurance policy requirements. Sometimes they can be very exacting: for example, when checks in transit at the time a bank is closed have been dishonored and used to bring a customer's total account balance above $100,000. In fairness, it must be added that, so far, payment of deposit insurance claims has usually been very prompt in comparison with delays by private sector insurance companies.

A recent legislative measure reduces deposit insurance coverage for special cases that qualify for more than the $100,000 limit. One of the provisions of the 1989 S&L bailout bill calls for "unifying" the deposit insurance policies of the different federal banking regulatory agencies. These provisions have resulted in a tightening of the rules to the strictest possible version. Their impact affects certain combinations of joint, fiduciary, custodial, testimentory, IRA. Keogh and other specialty accounts. A full description was printed in the Federal Register on December 21, 1989. Copies of the eighteen-page document may also be available from the FDIC's legal division. It is designated as FIL-25, dated 12/28/89.

Another recent policy change put forth by the FDIC is curtailment of pension plan deposit insurance coverage. Although political reaction may force the agency to back down, as of this writing, the FDIC has announced its intention to apply the $100,000 limit to certain pension plans



(called "457" plans) as if the plan were for a single person. These plans typically provide for employees of state and local governments and nonprofit agencies. Previously the policy had been to cover all pension plans in the amount of $100,000 for each of the plan participants. With many pension plan members locked into their employer's plan or otherwise caught by provisions that preclude a fast exit, the prospect looms that some may have their pensions wiped out by bank failures.

## *Situations in Which the Government's Deposit Insurance May Not Be Able to Repay Depositors*

Currently, the FDIC's Bank Insurance Fund has gross assets near $14 billion. Because a portion of this money is tied up in failed banks, the amount available for payouts is somewhat less. Since insured deposits at all banks total $2.1 trillion, the Bank Insurance Fund possesses considerably less than one cent per dollar of insured deposits. Viewed another way, failures of moderately large banks, such as Continental Illinois Bank in 1984, or First Republic Bank of Texas in 1988, typically cost the FDIC $4 billion to $6 billion. Thus, the Bank Insurance Fund could be strained by several such failures in a short period. If such strains should occur, the Federal Reserve will most likely make money available in an attempt to control the crisis—a crisis that would surely be set off by such a string of large bank failures. (This is not just a theoretical possibility. During the past several years, the Federal Reserve has quickly provided money to a number of banks and S&Ls to halt runs before they could get out of hand.)

The 1985 Ohio and Maryland crises, with so-called state insured S&Ls, illustrated how widespread runs on federally insured institutions might be controlled. In those states, the private deposit insurance did not have sufficient funds to pay off depositors at failed institutions. When it became known that there was no state backing for the insolvent deposit insurance fund, runs began at other S&Ls. State officials quickly declared a "bank holiday" and closed all of the then-uninsured S&Ls in the state. Within a few weeks the still-solvent S&Ls were reopened but withdrawal limitations of $500 to $700 per month were imposed. Although most of the depositors eventually got their money (years later), many suffered hardship, especially those who had committed downpayments to transactions involving a penalty for not following through in a timely fashion. Home purchases are examples of such transactions.

## *How the Government Could Change Present Deposit Insurance Payout Policies*

As stated earlier, if necessary, the government can avoid making good on deposit insurance claims simply by delaying them. Bank holidays have long been recognized as a means to put a hold on widespread panic. Since an open-ended deferral on the availability of people's money could cause political (as well as civil) tumult, and since the rationing approach in two states quickly led to relative calm, this alternative appears to be a likely future tool. Another attractive feature of rationing withdrawals is its face-saving political stance. Few, if any, of the government's assurances to insured account holders have ever included commitments to speedy refunds.

Other, more sinister responses to a deposit insurance crisis that could be adopted by cynical lawmakers include

- Forcing depositors to accept long-term, low-interest-rate U.S. government bonds or notes



- Adjusting the tax code to treat deposit account closings as casualty losses in the year the bank is closed, and insurance reimbursements as later-year income
- Synchronizing repayment delays to periods of high inflation so that the value of the deposit account refunds, when finally received, is sharply reduced

All of the foregoing maneuvers would still allow the assertion "No one has ever lost a dime of insured deposits" to continue to be made with legalistic correctness.

## *Relative Strength of the Three Federal Deposit Insurance Funds*

As explained above, the strength of federal deposit insurance does not lie in the size of the reserves, but rather in the government's repeated pledges to stand behind each of the funds in case of trouble. Since these pledges have yet to be seriously tested, the question is often asked, "How do the reserves in the deposit insurance funds compare with the amounts they could possibly be called upon to pay?" The amounts are broken down below.

| *Federal Deposit Insurance* | *Estimated Balance of Fund as of 12/31/89* | *Estimated Insured Deposits (or Shares) as of 12/31/89* | *Insurance Fund Reserves per Dollar of Insured Deposits* |
|---|---|---|---|
| FDIC Bank Insurance Fund (BIF) | $13 7 billion | $2.2 trillion | 0.6 cents |
| FDIC Savings Association Insurance Fund (SAIF) | None | $975 billion | 0.0 cents |

| *Federal Deposit Insurance* | *Estimated Balance of Fund as of 12/31/89* | *Estimated Insured Deposits (or Shares) as of 12/31/89* | *Insurance Fund Reserves per Dollar of Insured Deposits* |
|---|---|---|---|
| National Credit Union Share Insurance Fund (NCUSIF) | $2.0 billion | $165 billion | 1.3 cents |

It should be kept in mind that the insurance reserves given above are "gross" values. That is, they count money that may be tied up and not available to pay depositors, should a quick need arise. The federal deposit insurance agencies are usually tight-lipped about the actual amounts in the funds that are "liquid," or ready to be drawn upon immediately. However, private estimates are that between $4 billion and $8 billion of the Bank Insurance Fund is tied up in the ownership of, or loans to, reconstituted banks.

The Savings Association Insurance Fund (SAIF), which just received its start in late 1989 following the widely headlined insolvency of its forerunner, the Federal Savings and Loan Insurance Corporation, is not slated to receive any money until 1992. Instead, the premiums paid by the S&Ls are being used to fund the ongoing thrift bailout. In this environment, savings and loan association depositors must look to government promises and guarantees rather than the current, nonexistent reserves of SAIF.

The National Credit Union Share Insurance Fund, recapitalized in 1984 after having problems keeping up with failures in that industry, also is not as liquid as the total in the table would indicate. For example, among the fund's assets is a $2 million mortgage on the building used by the National Credit Union Administration.



## *"State" Deposit Insurance Funds*

Over the past two hundred years, there have been numerous deposit insurance plans set up by trade groups of financial institutions or state banking authorities. The reason for these plans, like the federal deposit insurance, has been to eliminate or sharply reduce the tendency for bank runs to develop. These deposit insurance attempts have been beset by two problems. One has been a lack of sufficient funds held in reserve to cover more than the failure of a few small banks. The other has been the unwillingness of the state or federal government to stand behind a plan once it gets into trouble. The 1985 Maryland and Ohio debacles typify the situation with nonfederal plans. Despite impressive names like Maryland Savings Share Insurance Corporation (MSSIC) and Ohio Guaranty Fund, there was no state support for thousands of depositors in insolvent thrifts in those states. (Later, in 1989, Maryland recognized its obligation and paid depositors there.) Less widely reported, but equally traumatic to the families that lost their savings, was the collapse, in 1983, of the Nebraska Depository Institution Guarantee Corporation.

In addition to the widespread coverage by the FDIC's Bank Insurance Fund (BIF) and Savings Association Insurance Fund (SAIF), some institutions have "excess FDIC coverage" under the auspices of plans provided by various banking associations. For example, the Massachusetts Central Fund provides deposit insurance "without any limit" to account holders in that state's savings banks. The fund, like other private deposit insurance, could cover only a few moderate-sized failures. Furthermore, state officials emphatically decline to pledge "full faith and credit" of the state as backing to the fund. Similar situations prevail in Pennsylvania, North Carolina and several other states.

Currently, most serious depositors ignore the additional coverage that the so-called state insurance funds provide. Instead, they direct their strategies to maximizing their coverage under the federal plans.

### *Uninsured Institutions*

Although most banking institutions in the U.S. have either the BIF, SAIF or NCUSIF insurance, there are a number of banks, ''near-banks'' and ''non-banks'' that do not. Categories of non-federally insured financial institutions are listed below.

- Ordinary state-chartered (old) banks that did not have to join the FDIC because they qualified for certain ''grandfathering'' provisions when the FDIC was formed in 1934; less than a few dozen of these remain.
- Commercial credit companies that allow ''deposit participation'' in their activities; hundreds, perhaps thousands, of these finance companies exist nationwide. They are usually small, family-owned operations that specialize in personal lending.
- Privately insured or non-insured credit unions; there are approximately three thousand of these institutions.
- ''Private'' banks, somewhat rare institutions that specialize in providing very personalized financial services to upscale clients; many are federally insured, a few are not.
- Limited service or ''non-bank'' banks, a development of the last five years, formed to pursue activities relating to the securities industry; there are several dozen of these institutions, some of which take in ''deposits'' and offer services similar to checking accounts.



### *Precautions You Can Take*

Federal deposit insurance, despite its risks and limitations, is the last line of defense most of us have against bank failure. Although it may be obvious, many people and businesses have lost money by not observing the following two rules.

1. Be sure your institution is BIF, SAIF or NCUSIF insured. If you do not see one of these three symbols displayed prominently, ask why. If you ask and are made to feel uncomfortable for asking, the institution probably is not federally insured. Bank failures have become so prominent in the modern financial landscape that now all bankers in the country understand (or should understand) the reasonable worries that their depositors have.
2. Be sure that *your account is also federally insured.* If you are in doubt, try to get your bank representative to put it in writing. (This may be difficult, especially for small amounts, simply because busy customer representatives may not want to bother, or may be reluctant to make assurances that they do not completely understand.) Your state or local consumer protection agency may be able to help.

### *Accounts Over $100,000*

One strategy is obvious—spread your money over many banks, never putting more than $100,000 in each. If you must invest $100,000 (for example, to take advantage of an attractive jumbo CD rate), have the interest sent to you or deposited into your account at a different bank, at the most frequent intervals possible. That way, the least possible amount of interest is at risk.

Joint accounts provide an easy way to extend coverage to $300,000. But the subtleties of current deposit insurance claim-settlement procedures should be understood before committing funds beyond $100,000. Also, all depositors with more than $100,000 in an institution need to be continually alert to rules changes that could place them at a disadvantage. In comparison to most government deposit insurance officials, anyone with over $100,000 of banked assets is quite well off. Large account holders should expect little sympathy from federal banking liquidators or deposit insurance adjusters. These officials usually possess personal accounts totaling well under the $100,000 limit. Indeed, one can expect to encounter the attitude "We have to insure you, but it is your responsibility to follow all of the rules for the insurance to work."

Trust accounts, IRAs, Keogh Plans and other combinations of account types can extend coverage to as much as $500,000 for a couple. Needless to say, considerable caution is indicated in the structuring of such arrangements, the considerations for which extend well beyond the scope of this book.



### *Additional Lines of Defense*

One lesson from the Ohio and Maryland crises is that different kinds of banking institutions may be affected in different ways should federal deposit insurance get into trouble, or if the government should declare "bank holidays." Large depositors and small account holders alike should spread their funds over various types of institutions, rather than simply choosing different institutions of the same kind. For example, diversification among banks, S&Ls and credit unions, as well as some non-bank investments, can be a prudent course. Many careful people also keep a cash contingency fund on hand, sufficient to cover a month of living expenses. Some people also maintain an additional three months of "liquidity" distributed over

- A charge card or two at a bank other than their regular bank
- A checking account at a bank other than the one at which they keep their savings
- A credit union share account
- A money market fund (not a bank; not federally insured) with check writing privileges

### *Watching for Trouble*

Increasingly, many account holders, and others who could be hurt by their banks' failure, are not relying solely on the backstop of federal deposit insurance. It is becoming more commonplace for private citizens and businesses alike to watch for indications that their financial institutions could be in trouble. They want to be able to take appropriate action before matters get to the deposit insurance claim stage.

Newspaper stories are often a tip-off that all is not well at a bank or S&L, particularly if the institution is prominent. However, by the time a bank's troubles have reached the press, it is often too late to do much more than watch the final drama unfold. There are other ways you can learn, early on, about your bank's condition. The next chapter explains how to identify and evaluate this information.



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# FINANCIAL INSTITUTIONS IN TROUBLE: WARNING SIGNALS

### *The Art of Doublespeak*

Suppose, tomorrow, you receive the following letter from your S&L or bank.

> Dear Mr. or Ms._____:
>
> As you know, Federal First Savings and Loan has grown with this community since 1934. Recently, as part of our ongoing effort to provide our customers with the best service possible, Federal First has joined the Resolution Trust Corporation's conservatorship program. We are excited about this new step, which adds one more aspect to the safety of your funds here. More information about our participation in this important federal program will follow soon. Meanwhile, we urge you to check into our special high yield money market account. . . .

While the letter is fictitious, the concept behind it is not. Would you instantly recognize this as a message that your institution had been taken over by the federal agency whose sole purpose is the liquidation of failed or failing thrifts? Would the soothing phrases and slick style cause your eyes to glaze over as you quickly sent the letter to the trash can—without understanding its concealed mes-